



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
OILDALE MUTUAL WATER COMPANY)

For Appellant: Merle H. Jenkins
Attorney at Law

For Respondent: Bruce W. Walker
 Chief Counsel

Paul J. Petrozzi
Counsel

O P I _ N I _ O N

This appeal is made pursuant to section 25667 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Oildale Mutual Water Company against proposed assessments of additional franchise tax and penalty in the total amounts of \$1,129.00 and \$3,998.00 for the income years ended February 28, 1973, and February 28, 1975, respectively, and against proposed assessments of additional franchise tax in the amounts of \$2,233.00 and \$4,805.00 for the income years ended February 28, 1974, and February 29, 1976, respectively.

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The sole issue raised by this appeal is whether appellant may deduct the interest income it derived from the investment of accumulated reserves in time deposits.

Appellant is a mutual water company established for the purpose of providing water to its shareholders. In order to meet the future costs of maintaining and expanding its water distribution system, appellant accumulated reserve funds from its charges for water. These reserves were deposited in financial institutions and produced interest income. In computing its tax liability for each of the years under appeal, appellant deducted that interest income from its gross income. Respondent denied these deductions and issued proposed assessments of additional franchise tax. Penalties were also imposed for the late filing of returns for the income years ended February 28, 1973, and February 28, 1975, pursuant to section 25931 of the Revenue and Taxation Code. Appellant protested the proposed assessments of tax but made no objection to the imposition of the penalties.

Section 24405 of the Revenue and Taxation Code permits associations organized and operated on a cooperative or mutual basis to deduct from their gross income "all income resulting from or arising out of business activities for or with their members. .. or when done on a nonprofit basis for or with nonmembers" Appellant contends that its interest income constituted income from such activity and is therefore deductible under the above provision.

On several occasions this board has considered factual situations similar to the instant case and has consistently held that the investment of reserves or surplus in interest-bearing accounts or securities is not a business activity within the meaning of section 24405. The subsequent interest earned is therefore not deductible., (Appeal of Unity Credit Union, Cal. St. Bd. of Equal., Jan. 6, 1977; Appeal of Mid-Cities Schools Credit Union, Cal. St. Bd. of Equal., Dec. 15, 1966; Appeal of Southern California Central Credit Union, Cal. St. Bd. of Equal., Feb. 3 1965; see also Woodland Production Credit Association v. Franchise Tax Board, 225 Cal. App. 2d 293 [37 Cal. Rptr. 231] (1964); Appeal of Woodland Production Credit Association Cal. St. Bd. of Equal., Feb. 19 1958.) These authorities appear to be controlling in this appeal as well. The fact that the interest income is to be used only

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for the repair, construction, and expansion of appellant's water facilities is irrelevant. The source of the earnings, and not what the earnings are to be used for, is what is determinative in the application of section 24405. (Appeal of Woodland Production Credit Association, supra; see also Woodland Production Credit Association v. Franchise Tax Board, supra; Appeal of Unity Credit Union, supra; Appeal of Mid-Cities Schools Credit Union, supra.)

Appellant has expressed doubt with respect to whether, as a water company meeting the restrictive provisions of sections 330.24 et seq. of the Civil Code, it comes within the purview of section 24405 of the Revenue and Taxation Code. No authority has been cited in support of this theory and we have found none. Absent such authority, it seems clear that section 24405 is applicable to appellant.

For the reasons set out above, we conclude that respondent's action in this matter must be sustained.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 25667 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of Oildale Mutual Water Company against proposed assessments of additional franchise tax and penalty in the total amounts of \$1,129.00 and \$3,998.00 for the income years ended February 28, 1973, and February 28, 1975, respectively, and against proposed assessments of additional franchise tax in the amounts of \$2,233.00 and \$4,805.00 for the income years ended February 28, 1974, and February 29, 1976, respectively, be and the same is hereby sustained.

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Done at Sacramento, California, this 16th day of
August, 1979, by the State Board of Equalization.

William H. Bennett, Chairman

Julius H. Hearn, Member

Geoffrey Kelly, Member

_____, Member

_____, Member